ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
Rate Regulation	)	

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REPLY COMMENTS OF DISCOVERY COMMUNICATIONS, INC.

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SUMMARY

In its opening comments, Discovery Communications, Inc., demonstrated that the Commission should implement the rate regulation provisions of the Cable Television Consumer Protection and Competition Act of 1992 in a manner that is fully sensitive to First Amendment concerns, that allows cable operators to pass-through the costs of system improvements and upgrades, and that allows the cable industry the flexibility necessary to meet consumer demand.

In these reply comments, Discovery demonstrates:

- That the arguments against flow-throughs of programming costs and system expansions are unsupported, and that not allowing flow-throughs would harm the quality and level of programming available to the public and create incentives for cable operators to shift programming to other tiers;
- That there is not sufficient cable industry information available on which to base a price cap regulatory regime;
- That the treatment under rate regulation of program packages multiplexed by the programmer should not depend upon the content of the programs; and
- That cable operators should be able to package pay-per-channel programming without rate regulatory concerns so long as the same programs are available on an "a la carte" basis.

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Discovery Communications, Inc. ("Discovery"), by its attorneys, hereby replies to the comments filed on the Commission's *Notice of Proposed Rulemaking*[1] to implement the rate regulation provisions of the Cable Television Consumer Protection and Competition Act of 1992 ("Cable Act").

I. INTRODUCTION AND SUMMARY.

In its opening comments, Discovery urged the Commission to rely on market forces to the extent possible to meet its obligations under the Cable Act and to the extent cable rate regulation is necessary that it be implemented in a manner that would preserve the incentives for providing high quality

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[1] *Implementation of the Cable Television Consumer Protection Act of 1992: Rate Regulation*, FCC 92-544 (released Dec. 24, 1992) (*"Notice"*), *summary published,* 58 *Fed. Reg.* 48 (1993).

programming at reasonable rates.[2] Discovery explained that only by preserving incentives for cable systems to invest in additional capacity and programming and according cable programmers and operators the flexibility necessary to compete and attract new customers, could the Commission effectuate the Congressional policy of ensuring "that cable operators continue to expand, where economically justified, their capacity and the programs offered over their cable systems."[3]

Specifically, Discovery expressed concern that "benchmark" regulation potentially could discourage cable systems from supporting high quality programming or expanding their system to make additional programming available. Thus, it recommended that if a form of benchmark regulation were adopted it be structured so that cable systems could "recapture" automatically increased costs of programming and system expansion.

Discovery also expressed concern with suggestions that the Cable Act was intended to restrict programmers in how they could

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[2] Discovery urged the Commission to be liberal in defining "effective competition" to ensure that nascent competition would not be hindered in its development and that First Amendment values be protected. While most commenters agreed with these views, some attempted to impose definitional standards that would never permit the "withering away" of rate regulation as contemplated by the Cable Act. Discovery strongly recommends that the FCC reject any such attempts and make plain its desire to rely on competitive forces wherever reasonable.

[3] *Cable Television Consumer Protection and Competition Act of 1992*, Pub. L. No. 102-385, § 2(b)(3), 106 Stat. 1463.

package and promote their services or unreasonably limit cable operators' flexibility to provide "a la carte" or pay-per-view programming. How a programming service is marketed obviously is critical to its success and affects that programmer's ability to provide diverse, high quality programs.

The comments for the most part reflect substantial agreement with Discovery's positions. A wide range of parties agreed that the FCC's rate regulation regime should take into account the Congress's recognition of the "public interest in having a technologically dynamic and economically healthy cable industry."[4] Many also stressed the importance of permitting programmers and cable operators to promote their services.

Some commenters, however, raised matters which could inadvertently create disincentives for continued growth in the quality and diversity of video programming delivered by cable. Moreover, a few would deny cable programmers and operators the ability to respond flexibly to consumer needs, particularly in the area of programming. For the reasons noted below, these results would not be in the public interest.

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[4] *Comments of the Consumer Federation of America* at 2 (Jan. 27, 1993).

II. THE COMMISSION SHOULD DISREGARD PROPOSALS WHICH WOULD CREATE DISINCENTIVES TO THE CONTINUED GROWTH IN VIDEO PROGRAMMING QUALITY AND DIVERSITY.

In its opening comments, Discovery demonstrated that the public interest requires the Commission to adopt regulatory policies that would allow cable operators to pass through net increased costs in system expansion and improvements and in programming.[5] Discovery, however, opposed the suggestion that the Commission use price cap regulation to moderate increases from the benchmark. Its concern was that the FCC did not have sufficient data about the cable industry to allow it to implement price cap regulation without significantly harming cable programming.[6] While some commenters disagreed with Discovery's views, their positions run contrary to the public interest and are unsupported by the statute.

A. The Public Interest Requires That Cable Operators Be Able To Pass Through the Costs of System Improvement and Programming.

Discovery's initial comments expressed concern that benchmark regulation inherently can create disincentives for program and cable system expansion.[7] In its discussion of the problem, the National Association of Broadcasters described the

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[5] *Comments of Discovery Communications, Inc.* at 6-10 (Jan. 27, 1993).

[6] *Id.* at 9-10.

[7] *Id.* at 6-9.

problem as the "candy bar" syndrome -- where a producer lowers the quality or size of its product in order to gain profits otherwise denied it.[8] To avoid this potential disincentive, many commenters supported Discovery's proposal: If benchmark regulation is adopted, cable operators should be allowed to flow-through their net increased costs for programming and system improvements such as channel expansion or conversion to new technologies.[9]

A minority of commenters opposed pass-throughs of system improvements and programming costs, fearing that such a system would prevent programming cost reductions from being passed on to subscribers and would create incentives to increase costs excessively.[10] These concerns, however, are speculative at best.

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[8] *"Efficient Regulation of Basic-Tier Cable Rates," by Haring, Rohlfs, and Shooshan, attached to Comments of the National Association of Broadcasters* at 9 (Jan. 27, 1993).

[9] *Comments of E! Entertainment Television, Inc.* at 4 (Jan. 27, 1993). *See also Charles River Associates* an analysis of Cable Television Rate Regulation at 3 (Jan. 27, 1993) ("Charles River Associates") (submitted with Comments of Tele-Communications, Inc.) (operators should be able to recover cost increases relating to service quality improvements under any rate regime); *Comments of the Motion Picture Association of America* at 1-4 (Jan. 27, 1993); *Initial Comments of Turner Broadcasting System, Inc.* at 5 (Jan. 27, 1993) ("we urge the Commission to adopt the proposal that permits cable systems to directly pass through increases in programming costs without regard to the effect on any benchmarks or 'penalty' under the regulatory scheme adopted"); *Comments of ESPN, Inc.* at 6-7 (Jan. 27, 1993).

[10] *Charles River Associates* at 34-35 (alleging that pass-throughs might reduce a cable operator's incentive "to drive a hard bargain with programmers").

Regardless of what cable programmers may wish to charge for their programming, cable operators simply have no incentive to pay sums for video programming that they do not believe they can recover through subscriber charges. Offerings that are overpriced will not be successful and will harm both the programmer and the cable system operator. Given this, it is highly unlikely that a pass-through of programming costs would lead to spiraling cost increases. On the other hand, prohibiting such pass-throughs inevitably would harm consumers by discouraging the acquisition of diverse and high quality programming by cable operators and by discouraging investment in new programs by video programmers.

Prohibiting pass-throughs would also create a strong incentive for cable operators to shift non-broadcast signals from the basic tier to higher tiers. As ESPN, Inc., commented: "The Commission has recognized that programming costs are one of the direct costs of providing cable service and that allowing cable operators to pass these costs through to subscribers might reduce the cable operator's incentive to remove highly valued programming from the basic or other widely distributed tier."[11] The failure to allow such pass-throughs would conflict with the Act's intention not to create, as the *Notice* recognizes,

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[11] *Comments of ESPN* at 6 (*citing Notice* ¶ 54).

"unintended limits on a cable operator's discretion to tier programming services."[12]

Moreover, encouraging retiering by prohibiting pass-throughs would harm programmers by diminishing their potential audience. A number of programmers explained that cable operators have successfully maximized consumer choice and spread costs over a wider base by offering cable channels in a single package provided to all subscribers.[13] It was not the purpose of the Cable Act to injure programmers by creating incentives to drive cable programming to tiers with smaller viewerships. There is little doubt that hampering the cable operators' flexibility in this manner would deserve the public interest, and should be avoided.

B. Sufficient Industry Information Does Not Exist To Allow Price Cap Regulation To Be Adopted.

The cable industry and others uniformly opposed the use of price cap regulation to govern future price increases. Although a few commenters expressed support for price caps, their arguments do not withstand scrutiny.

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[12] *Notice* ¶ 32.

[13] *See Comments of the Arts and Entertainment Network* at 4-5 (Jan. 27, 1993); *Comments of ESPN* at 3-4 (Jan. 27, 1993) ("FCC rate formulas for the basic and the non-basic service tiers must not discourage cable operators from inclusion of the cable networks on these widely distributed tiers").

Regardless of the merits of price cap regulation, the fact is, as Discovery explained in its opening comments, the FCC has insufficient experience and data on which to base a cable industry price cap formula.[14] BellSouth's suggestion that the Commission apply the same productivity offset used for telephone companies simply ignores the substantial differences between the telephone and cable industries.[15] There is no record evidence that these two industries, or their differing technologies, have had similar productivities. Given this, applying the productivity factor used in telephony regulation could have severe public interest consequences.[16]

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[14] *Discovery Comments* at 9-10 (Jan. 27, 1993); *accord Comments of the NYNEX Telephone Companies* at 7 (Jan. 27, 1993)("historical productivity estimates need to be developed" for the cable industry).

[15] *Comments of BellSouth* at 15 (Jan. 27, 1993); but see *Comments of Cole, Raywid & Braverman* at 21-24 (Jan. 27, 1993) (summarizing the substantial differences between cable and telephone industries).

[16] An analysis attached to the comments of the National Association of Broadcasters states that the incentives created by both price caps and benchmarks to degrade quality are "much more serious for cable than telephony because the quality of cable service can be much more easily degraded. The quality of cable service can be degraded simply by reducing expenditures on programming and other variable inputs." *"Efficient Regulation of Basic-Tier Cable Rates," by Haring, Rohlfs, and Shooshan, attached to Comments of the National Association of Broadcasters,* at 10 (filed Jan. 27, 1993).

III. THE COMMISSION SHOULD ENSURE THAT CABLE PROGRAMMERS AND OPERATORS HAVE THE FLEXIBILITY NEEDED TO RESPOND TO CHANGING CONSUMER NEEDS.

The comments filed in this proceeding reflect some disagreement regarding the proper treatment of the promotion and packaging of "a la carte" programming. Discovery's opening comments urged the Commission to recognize that the Cable Act did not intend to regulate how a programmer packages its offerings.[17] Thus the FCC should reject any suggestion that programming packages developed by programmers should be considered tiers and subject to regulation. Discovery also argued that packages of per-channel programming put together by cable operators should not be subject to rate regulation if the programming components of the package are also available on an *"a la carte"* basis.

A. Programmers Should Be Free to Package Their Own Programming As The Market Dictates.

Discovery's opening comments explained that "multiplexed" and other channel grouping packaged by the programmer should not be regulated. This approach is consistent with the Cable Act, which does not attempt to regulate how programmers package their

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[17] *Discovery Comments* at 12-16. As NCTA points out, the equipment provisions of the Act address concerns with rate levels. *Comments of the National Cable Television Association* at 44-54 (Jan. 27, 1993). Obviously, the promotional offering of installation and equipment services poses no danger of excessive prices, while serving the public interest by expanding the subscriber base and helping achieve economies of scale.

channels. Rather, the Cable Act's provisions in this regard are intended to restrict the cable operator's ability to force subscriber "buy-throughs."[18]

In its comments, the Consumer Federation of America agrees that "multiplexed" (or "time-shifted") channels should not be regulated, but asserts that channels packaged by a programmer containing different programming should be treated as a "tier."[19] However, no reason is given for such a distinction, other than an unexplained assertion that such an approach would better effectuate congressional intent. Discovery respectfully disagrees; indeed, the better view is, as Discovery has explained, that a programmer should be free to package its channels in any manner that it believes best meets viewer demands. In so doing, the programmer accepts the risk that the entire package will be insufficiently attractive to consumers.[20] The regulatory status of channels multiplexed or packaged by a programmer should not turn on their content.

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[18] *See* Cable Act at § (b)(8).

[19] *Comments of CFA* at 135-136.

[20] On the other hand, packaging programs together will permit programmers to start new channels and services more cheaply than otherwise would be possible and thus directly benefit consumers with more varied and less costly programming.

B. Cable Operators Should Be Able To Package Pay-Per-Channel Programming Without Rate Regulatory Concern, If The Same Programs Are Also Available On An *"A La Carte"* Basis.

CFA and others also err in contending that a package of pay-per-channels assembled by the cable operator should be regarded as a tier and rate regulated when the channels are individually available.[21] As long as the channels within the grouping also are separately available, the rates for the entire package must be reasonable. This is because the separate availability of the grouped channels constitutes an internal, self-policing mechanism.

Nor should such a grouping give rise to concerns about buy-throughs. Again, because the channels are available individually, there is no buy-through problem.[22] However, such groupings can and do benefit both consumers and programmers by making diverse, high quality programming more widely available. Therefore, such groupings should not be rate regulated.

IV. CONCLUSION.

For the reasons stated herein, and in its opening comments, Discovery Communications respectfully urges the Commission to

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[21] *Comments of CFA* at 136 (Jan. 27, 1993); *accord Comments of NATOA at* 78 (stating that a package of premium services, even if offered "*a la carte*," constitute a tier).

[22] *Comments of Discovery re Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992* (Feb. 9, 1993).

implement the rate regulation provisions of the Cable Act in a manner that does not constrain the ability of the video programming industry to meet consumer needs.

Respectfully submitted,

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